



Department of Natural Resources

Outdoor Heritage Fund Expenditures

Internal Controls and Compliance Audit

July 2013 through February 2016

January 13, 2017
REPORT 17-02

Financial Audit Division

OFFICE OF THE LEGISLATIVE AUDITOR

STATE OF MINNESOTA

Office of the Legislative Auditor Financial Audit Division

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OFFICE OF THE LEGISLATIVE AUDITOR

State of Minnesota • James Nobles, Legislative Auditor

January 13, 2017

Representative Sondra Erickson, Chair
Legislative Audit Commission

Members of the Legislative Audit Commission

Mr. Tom Landwehr, Commissioner
Department of Natural Resources

This report presents the results of our internal controls and compliance audit of the Department of Natural Resources' expenditures from the Outdoor Heritage Fund for the period from July 1, 2013, through February 29, 2016. The objectives of this audit were to determine if the department had adequate internal controls for its Outdoor Heritage Fund expenditures and complied with finance-related legal requirements.

We discussed the results of the audit with the department's staff on August 2, 2016, upon conclusion of our fieldwork. We delayed the public release of this report because we planned to release it at the same time as our annual Legacy compliance report. Since that report is still in process, we decided not to hold up the release of this report any longer. We plan to release our first annual Legacy compliance report before the end of January 2017.

This audit was conducted by Tracy Gebhard, CPA (Audit Director) and assisted by auditors Natalie Mehlhorn and Michelle Bilyeu. We received the full cooperation of the department's staff while performing this audit.

Handwritten signature of James R. Nobles in black ink.

James R. Nobles
Legislative Auditor

Handwritten signature of Cecile M. Ferkul in black ink.

Cecile M. Ferkul, CPA, CISA
Deputy Legislative Auditor



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Report Summary

Background

The Outdoor Heritage Fund is one of four funds created in 2008 when voters approved an amendment, commonly referred to as the “Legacy Amendment,” to the *Minnesota Constitution*.¹ The amendment increased the state’s sales tax by three-eighths of one percent for 25 years and dedicated 33 percent of the additional revenue to the Outdoor Heritage Fund. According to the Legacy Amendment, money from the Outdoor Heritage Fund must be used to “restore, protect, and enhance wetlands, prairies, forests, and habitat for fish, game, and wildlife.”

During the timeframe of our audit, July 2013 through February 2016, the Department of Natural Resources was the largest recipient of appropriations from the Outdoor Heritage Fund. Our audit focused on whether the department had adequate internal controls over its use of the money it received from the fund and whether the department complied with the finance-related legal requirements we selected for testing.

Unlike in previous audits, we did not test compliance with two legal requirements relevant to the use of Legacy money. We did not test the two requirements because their meanings are not sufficiently clear to provide distinct testing criteria. We did not test, 1) whether the department complied with the Legacy Amendment requirement that Legacy money must be used to “supplement traditional sources of funding...and may not be used as a substitute” or, 2) whether administrative costs the department allocated to Legacy appropriations complied with the statutory requirement that Legacy money be used only for costs that are “directly related to and necessary for” the purpose and conditions stated in the relevant appropriation law.²

Conclusion

The Department of Natural Resources designed and implemented internal controls that effectively managed the risks related to its use of money from the Outdoor Heritage Fund, and the department complied with the legal requirements we tested. The department also resolved certain prior audit findings we re-examined in this audit.³

¹ *Minnesota Constitution*, art. XI, sec. 15.

² Administrative costs (also sometimes referred to as indirect or overhead costs) are costs that are related to the operation of the department as a whole as opposed to expenses related to specific individual projects or appropriations. Examples of administrative costs include facility management, accounting, human resources, legal, and information technology services.

³ Office of the Legislative Auditor, Financial Audit Division Report 14-13, *Department of Natural Resources*, Findings 1 and 4 (St. Paul, MN, April 17, 2014) and Financial Audit Division Report 11-27, *Legacy Funds: Outdoor Heritage, Clean Water, and Parks and Trails*, Findings 1, 3, 4, and 6 (St. Paul, MN, November 30, 2011).



Background

In 2008, Minnesota voters approved a constitutional amendment, commonly referred to as the “Legacy Amendment.” The amendment increased the state sales tax by three-eighths of one percent for 25-years.⁴ In this report, we refer to all of the additional sales tax revenue as “Legacy money.”

The amendment requires 33 percent of Legacy money to be deposited in the Outdoor Heritage Fund and to be used to “restore, protect, and enhance wetlands, prairies, forests, and habitat for fish, game, and wildlife.”⁵

In anticipation that voters would approve the Legacy Amendment, the 2008 Legislature established the Lessard-Sams Outdoor Heritage Council to make recommendations on which programs and projects should be funded with money from the Outdoor Heritage Fund.⁶ The council consists of 12 members: 4 public members appointed by the Governor, 2 members of the Senate, 2 public members appointed by a Senate committee, 2 members of the House of Representatives, and 2 public members appointed by the Speaker of the House of Representatives. The council submits its recommendations to the Legislature no later than January 15 each year. The Legislature considers the council’s recommendations and appropriates money from the Outdoor Heritage Fund to certain state agencies and other organizations to support various programs and projects.

State law says that as a condition of accepting money from the fund, a recipient must submit “an accomplishment plan and periodic accomplishment reports to the Lessard-Sams Outdoor Heritage Council.”⁷ The law states further that an organization may not spend money appropriated from the Outdoor Heritage Fund until the council has approved the organization’s accomplishment plan for a specific project. Among other items, the plan must identify how the project will achieve outcomes measured in terms of “wetlands, prairies, forests, and fish, game, and wildlife habitat restored, protected, and enhanced.” In addition a recipient must provide the council with an evaluation of what was accomplished with the money they received.

⁴ The “Legacy Amendment,” *Minnesota Constitution*, art. XI, sec. 15, provides for the distribution of the additional dedicated sales tax revenue into four funds, as follows: Outdoor Heritage Fund, 33 percent; Clean Water Fund, 33 percent; Parks and Trails Fund, 14.25 percent; and the Arts and Cultural Heritage Fund, 19.75 percent.

⁵ The Legacy Amendment also defines the purposes for which money from the other Legacy funds may be used.

⁶ *Laws of Minnesota* 2008, chapter 368, art. 2, sec. 14, sub. 2, established the Lessard-Sams Outdoor Heritage Council, its membership requirements, and imposed various requirements on the council and entities using Outdoor Heritage Fund money.

⁷ *Minnesota Statutes* 2015, 97A.056, subd. 12.

Table 1 shows the largest recipients of legislative appropriations from the fund in fiscal years 2014, 2015, and 2016.

Table 1
Outdoor Heritage Fund Appropriations
For Fiscal Years 2014, 2015, and 2016
(In Thousands)

<u>Entities</u>	<u>2014</u>	<u>2015</u>	<u>2016</u>	<u>Total</u>
Department of Natural Resources	\$67,577	\$ 92,313	\$89,077	\$248,967
Board of Water and Soil Resources	21,690	16,422	7,513	45,625
Legislature	483	585	608	1,676
University of Minnesota	<u>1,000</u>	<u>0</u>	<u>0</u>	<u>1,000</u>
Total	<u>\$90,750</u>	<u>\$109,320</u>	<u>\$97,198</u>	<u>\$297,268</u>

Sources: *Laws of Minnesota* 2013, chapter 137, art. 3; *Laws of Minnesota* 2014, chapter 226 and chapter 256, art. 1; and *Laws of Minnesota* 2015, chapter 2, art.1.

Table 2 shows the Department of Natural Resources expenditures from its appropriations during the same period.

Table 2
Department of Natural Resources
Expenditures from the Outdoor Heritage Fund
July 2014 through June 2016
By Fiscal Year
(In Thousands)

<u>Expenditure Type</u>	<u>2014</u>	<u>2015</u>	<u>2016¹</u>	<u>Total</u>	<u>Percent of Total</u>
Grants	\$47,844	\$38,739	\$54,890	\$141,473	74%
Land Acquisitions and Easements	7,789	10,583	4,294	22,666	12%
Payroll	2,012	2,285	2,400	6,697	3%
Professional and Technical Services	2,065	1,607	1,532	5,204	3%
Supplies and Equipment	411	445	736	1,592	1%
Other Expenditures ²	<u>2,746</u>	<u>4,652</u>	<u>5,531</u>	<u>12,929</u>	<u>7%</u>
Total	<u>\$62,867</u>	<u>\$58,311</u>	<u>\$69,383</u>	<u>\$190,561</u>	<u>100%</u>

¹ While our audit scope included expenditures through February 29, 2016, for comparison purposes, this table includes all fiscal year 2016 expenditures.

² Other expenditures include building, infrastructure, travel, and other miscellaneous items.

Source: State of Minnesota's accounting system.

Audit Objective, Scope, and Methodology

The objective of our audit was to answer the following questions:

- Did the department have adequate internal controls to provide reasonable assurance that it used money from the Outdoor Heritage Fund for the purposes specified in appropriation laws; accurately paid grant recipients and vendors; complied with the finance-related legal requirements we tested; and created reliable financial data?
- Did the department comply with the finance-related legal requirements we selected for testing?
- Did the department resolve the prior audit findings we re-examined in this audit related to its use of money from the Outdoor Heritage Fund?⁸

To meet our audit objective, we obtained and analyzed the accounting data for the period from July 2013 through February 2016 to identify unusual trends or significant changes in financial operations. In that process, we considered the risk of errors in the accounting records. From the accounting records, we selected a sample of financial transactions and reviewed supporting documentation to determine whether the department's internal controls were effective and the department complied with the requirements we selected for testing.

We examined the following types of financial transactions:

- Grant expenditures
- Land and easement acquisition expenses and related fees
- Construction and improvement expenditures
- Supplies
- Travel-related expenses
- Personnel costs

We conducted the audit in accordance with generally accepted government auditing standards.⁹ Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objective.

⁸ Office of the Legislative Auditor, Financial Audit Division Report 14-13, *Department of Natural Resources*, Findings 1 and 4 (St. Paul, MN, April 17, 2014) and Financial Audit Division Report 11-27, *Legacy Funds: Outdoor Heritage, Clean Water, and Parks and Trails*, Findings 1, 3, 4, and 6 (St. Paul, MN, November 30, 2011).

⁹ U.S. Government Accountability Office, *Government Auditing Standards*, December 2011.

Audit Criteria

We assessed the department's internal controls over these transactions using the internal control standards published by the U.S. Government Accountability Office.¹⁰ Specifically, for internal controls over grants, we assessed the department against its own grant-related policies and procedures and the policies and procedures established by the Office of Grants Management in the Department of Administration.¹¹

To establish legal compliance criteria for the grants and other expenditures we tested, we examined the requirements in the following documents:

- *Minnesota Constitution*, art. XI, sec.15 (“Legacy Amendment”)
- *Laws of Minnesota* 2013, chapter 137, art. 1
- *Laws of Minnesota* 2014, chapter 226 and chapter 256, art. 1
- *Laws of Minnesota* 2015, First Special Session, chapter 2, art. 1
- *Minnesota Statutes* 2015, 84.0272, 84.96, and 97A.056
- Office of Grants Management policies
- Department of Natural Resources policies and procedures

Unlike in previous audits, we did not test compliance with two legal requirements relevant to the use of Legacy money; we did not test these requirements because their meanings are not sufficiently clear to provide distinct testing criteria. We did not test, 1) whether the department complied with the Legacy Amendment requirement that Legacy money must be used to “supplement traditional sources of funding...and may not be used as a substitute” or, 2) whether administrative costs the department allocated to Legacy appropriations complied with the statutory requirement that Legacy money be used only for costs that are “directly related to and necessary for” the purpose and conditions stated in the relevant appropriation law.¹²

OLA's previous testing of compliance with these requirements has shown that there are different ways to interpret their meanings. OLA's interpretations generally limit or restrict allowable uses of Legacy money; agencies' interpretations generally do not. The different interpretations have created an unresolved dispute between OLA and state agencies (including the Department of

¹⁰ Comptroller General of the United States, Government Accountability Office, *Standards for Internal Control in the Federal Government*, (Washington, D.C., September 2014). In September 2014, the State of Minnesota adopted these standards as the internal control framework for the state's executive branch.

¹¹ *Minnesota Statutes* 2015, 16B.97, subd. 4, required the commissioner of Administration to “...create general grants management policies and procedures that are applicable to all executive agencies.”

¹² Administrative costs (also sometimes referred to as indirect or overhead costs) are costs that are related to the operation of the department as a whole as opposed to expenses related to specific individual projects or appropriations. Examples of administrative costs include facility management, accounting, human resources, legal, and information technology services.

Management and Budget) over the meanings of the requirements. Until either the Legislature or the courts clarify the meaning of these two requirements, OLA lacks sufficient criteria to design effective compliance tests.

Conclusion

The Department of Natural Resources designed and implemented internal controls that effectively managed the risks related to its use of money from the Outdoor Heritage Fund, and complied with the legal requirements we tested. The department resolved the prior audit findings we re-examined in this audit, as noted in the following Appendix.¹³

¹³ Office of the Legislative Auditor, Financial Audit Division Report 14-13, *Department of Natural Resources*, Findings 1 and 4 (St. Paul, MN, April 17, 2014) and Financial Audit Division Report 11-27, *Legacy Funds: Outdoor Heritage, Clean Water, and Parks and Trails*, Findings 1, 3, 4, and 6 (St. Paul, MN, November 30, 2011).



Appendix

Status of Selected Prior Audit Findings

In this section, we discuss our approach to determine whether the department resolved certain audit findings included in two prior audit reports.¹⁴ In all instances, we concluded the department had resolved the prior audit findings we tested.

Office of the Legislative Auditor, Financial Audit Division Report 11-27, *Legacy Funds: Outdoor Heritage, Clean Water, and Parks and Trails*

This report, issued in November 2011, examined expenditures of money from three Legacy funds (Outdoor Heritage, Clean Water, and Parks and Trails) during a period from July 2009 through January 2011 by the Department of Natural Resources, Pollution Control Agency, and the Board of Water and Soil Resources. Four of the report's six findings, as restated below, related to the Department of Natural Resources' use of money from the Outdoor Heritage Fund:

- **Finding 1** - The Department of Natural Resources ... did not ensure that certain costs paid with money appropriated from Legacy funds complied with the restricted uses of those funds.

OLA Follow-up: We followed up on one weakness included in this finding. We tested a sample of payroll expenditures charged to the Outdoor Heritage Fund during the period from July 2013 through February 2016 to determine whether the department had implemented a process to periodically validate that allocated payroll costs corresponded to actual work employees performed for the purposes of specific appropriations of Legacy money. For sample items we tested where the employee's time was allocated, we discussed with department supervisors and staff to determine how the department validated the allocations corresponded to actual work performed.

Finding Status: The department established effective periodic reviews of allocated payroll costs to ensure those costs corresponded to the employees' actual work. We did not follow up on other aspects of this finding.

- **Finding 3** - The Department of Natural Resources ... paid some grantees for costs without ensuring that the costs complied with the restrictions applicable to the uses of Legacy funds.

¹⁴ Office of the Legislative Auditor, Financial Audit Division Report 14-13, *Department of Natural Resources*, Findings 1 and 4 (St. Paul, MN, April 17, 2014) and Financial Audit Division Report 11-27, *Legacy Funds: Outdoor Heritage, Clean Water, and Parks and Trails*, Findings 1, 3, 4, and 6 (St. Paul, MN, November 30, 2011).

OLA Follow-up: Our testing of grant reimbursements during the period of July 2013 through February 2016 confirmed that the department complied with restrictions related to the Outdoor Heritage Fund and only paid for costs listed in the projects' approved accomplishment plans.

Finding Status: Resolved.

- **Finding 4** - The Department of Natural Resources did not accurately pay some reimbursement requests for grants from the Outdoor Heritage Fund.

OLA Follow-up: We discussed the finding with department staff and tested key controls, including a test of a sample of grant payments during the period from July 2013 through February 2016. We found that the department accurately paid grant reimbursement requests.

Finding Status: Resolved.

- **Finding 6** - The Department of Natural Resources did not adequately safeguard state warrants held by employees for land acquisition closings.

OLA Follow-up: The department changed its procedures to ensure it safeguarded and limited the amount of time it held state warrants. Our testing of land acquisitions during the period from July 2013 through February 2016 verified the department implemented this new procedure.

Finding Status: Resolved.

**Office of the Legislative Auditor, Financial Audit Division Report 14-13,
*Department of Natural Resources***

This report, issued in April 2014, examined the internal controls and compliance of the Department of Natural Resources for various types of receipts and expenditures, including grant expenditures from the Outdoor Heritage Fund, during the period from July 2010 through February 2013. Two of the report's ten findings, as restated below, related to the Department of Natural Resources' use of money from the Outdoor Heritage Fund

- **Finding 1**- The Department of Natural Resources did not adequately verify the accuracy of hours worked and allocation of payroll costs for employees that did not complete their own timesheets and direct supervisors that did not approve their hours in the state's automated time reporting system. In addition, the department did not review a key payroll system report to ensure the overall accuracy of payments to employees. (This finding was a repeat of Finding 1 from the 2011 report because it was not resolved at the time of our 2014 audit.)
-

OLA Follow-up: We followed up on one weakness included in this finding. We tested a sample of payroll expenditures charged to the Outdoor Heritage Fund during the period from July 2013 through February 2016 to determine whether the department had implemented a process to periodically validate that allocated payroll costs corresponded to actual work employees performed for the purposes of specific appropriations of Legacy money. For sample items we tested where the employee's time was allocated, we discussed with department supervisors and staff to determine how the department validated the allocations that corresponded to actual work performed.

Finding Status: The department established effective periodic reviews of allocated payroll costs to ensure those costs corresponded to the employees' actual work. We did not follow up on other aspects of this finding.

- **Finding 4** – The Department of Natural Resources did not comply with certain state grant policies and department guidelines for grants paid from the Outdoor Heritage Fund and the Environment and Natural Resources Trust Fund.

OLA Follow-up: Our testing of grant reimbursements during the period from July 2013 through February 2016 paid for with Legacy money from the Outdoor Heritage Fund showed that the department complied with state grant policies and its guidelines. The department developed a process to effectively monitor grant recipients throughout the cycle of the grant. In addition, the department obtained all land acquisition documentation before it made final payments and closed the grants.

Finding Status: Resolved.

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